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MEMORANDUM

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2002 MAY -3 P 2:30

AZ CORP COMMISSION
DOCUMENT CONTROL

TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division

DATE: May 3, 2002

RE: STAFF REPORT FOR DYNEGY ENERGY SERVICES, INC. APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE COMPETITIVE RETAIL ELECTRIC SERVICES AS AN ELECTRIC SERVICE PROVIDER PURSUANT TO A.A.C. R-14-2-1601 ET SEQ. (DOCKET NOS. E-04072A-01-0988 AND E-03662A-02-0319)

Attached is the Staff Report for the above referenced application. The Applicant is applying for approval to provide the following services:

- Electric Generation
- Reseller of Metering Services
- Reseller of Meter Reading Services

Staff is recommending approval of the application following a hearing.

EGJ:EAA:rdp

Originator: Erinn Andreasen

Attachment: Original and Ten Copies

Arizona Corporation Commission

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Service List for: Dynegy Energy Services, Inc.
Docket Nos. E-04072A-01-0988 and E-03662A-02-0319

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

DYNEGY ENERGY SERVICES, INC.

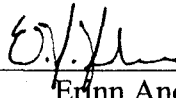
DOCKET NOS. E-04072A-01-0988 AND E-03662A-02-0319

APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO
PROVIDE COMPETITIVE RETAIL ELECTRIC SERVICES AS AN ELECTRIC SERVICE
PROVIDER PURSUANT TO A.A.C. R-14-2-1601 ET SEQ.

May 3, 2002

STAFF ACKNOWLEDGMENT

The Staff Report for Dynegy Energy Services, Inc., Docket Nos. E-04072A-01-0988 and E-03662A-02-0319, was the responsibility of the Staff member listed below. Erinn Andreasen was responsible for the review and analysis of the Applicant's application for a Certificate of Convenience and Necessity to provide competitive retail electric services as an Electric Service Provider.



Erinn Andreasen
Public Utilities Analyst

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1. INTRODUCTION

On December 19, 2001, Dynegy Energy Services, Inc. ("Dynegy" or "Company") filed an application for a Certificate of Convenience and Necessity ("CC&N") to provide competitive retail electric services as an Electric Service Provider ("ESP") in the State of Arizona.

In its application, Dynegy indicated that it had merged with its Parent, Illinova Energy Partners, Inc. ("Illinova") and absorbed the entire company into Dynegy. Dynegy also asserts that Illinova is no longer doing business and that there is no longer a need for Illinova to retain a Certificate of Convenience and Necessity. In a letter dated April 26, 2002, Dynegy requested that Illinova's CC&N be cancelled by the Commission. This request has been treated as a new application for a cancellation of a CC&N and assigned a new Docket No. E-03662A-02-0319. The request for a cancellation of Illinova's CC&N is being addressed in conjunction with Dynegy's application for a CC&N. Therefore, Staff recommends that the CC&N issued to Illinova Energy Partners, Inc. in Decision No. 61707, Docket No. E-03662A-98-0675 be cancelled.

Article XV, Section 2 of the Arizona Constitution and the Arizona statutes governing public service corporations give the Commission full power to regulate the State's public service corporations. Inherent in those powers is the authority to certificate public service corporations to provide competitive retail electric services and establish just and reasonable rates for these services. The Commission has rules, Title 14, Chapter 2, Article 16 of the Arizona Administrative Code ("Retail Electric Competition rules"), that serve as a framework for processing applications to provide competitive retail electric services.

Staff's review of this application addresses the overall fitness of the Company to receive a CC&N.

2. APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY

This section of the Staff Report contains descriptions of the geographic market to be served by Dynegy, its proposed services, and its technical and financial capabilities to provide the proposed services.

2.1 DESCRIPTION OF THE GEOGRAPHIC MARKET TO BE SERVED

Dynegy requests the authority to provide competitive retail electric services in all areas in the state that are determined by the Commission to be open to retail electric competition.

2.2 DESCRIPTION OF PROPOSED SERVICES

The applicant is seeking Commission certification as an ESP and as a Load Serving Entity. As a Load Serving Entity, Dynegy will reserve transmission and distribution services from the Utility Distribution Company ("UDC") in order to supply electricity to the customer's

site. In its application, Dynegy indicated that it proposes to sell electric generation and offer it to large commercial and industrial retail customers.

According to its proposed tariff, Dynegy also intends to resell metering service and meter reading service by contract with a Commission-certificated ESP that is also a Meter Service Provider ("MSP") or Meter Reading Service Provider ("MRSP"). Dynegy seeks authority to resell the MSP and MRSP services, because it is not currently seeking certification to perform the services itself.

Dynegy would be required to acquire Commission approval in another CC&N application prior to providing the metering services itself.

Dynegy does not own any electrical generating capacity and will acquire generation to serve its load from the wholesale market.

2.3 FINANCIAL CAPABILITY TO PROVIDE THE PROPOSED SERVICES

Dynegy was incorporated in the State of Delaware on February 17, 2000. Dynegy has submitted the annual report for 2001 of its parent company, Dynegy, Inc. The audited financial statements for the year ended December 31, 2001, lists total assets of \$24.9 billion, total liabilities of \$17.4 billion, stockholders equity of \$4.7 billion, and a net income of \$648 million, on total revenues of \$42.2 billion. Based upon this information, Staff believes the Company has sufficient financial resources available to meet its capitalization requirements or incur operating losses.

2.4 TECHNICAL CAPABILITY

Dynegy has indicated in its application that it is certificated to provide retail electric services in New York, Illinois, California, Texas, Ohio, and Michigan. Copies of these certificates and or supporting documentation were provided with Dynegy's application. Dynegy has indicated that it currently provides retail electric service in Illinois, California, and Texas.

Dynegy has identified five personnel with experience in an energy-related field. The personnel identified have a combined experience in excess of 45 years in the areas of scheduling, trading, retail operations, customer management, accounting, and marketing and sales. In its application, Dynegy has indicated that the Company or its affiliates have been operating a real-time, power-scheduling center located at its parent company's headquarters in Houston, Texas. The facility allows Dynegy to coordinate and manage scheduling changes, reserve implementations, curtailment orders and interruption plans for current customers.

Staff believes that Dynegy's technical experience in the retail electric market will enable it to perform as a reliable and capable ESP in the Arizona retail electric service market.

2.5 ESTABLISHING RATES AND CHARGES

A. Introduction

The electric competition rules establish a process for the introduction of competition in the provision of competitive electric services, manifested in a pricing policy that contemplates unbundled, competitive rates for all competitive services including generation of electricity and separate rates for the noncompetitive services of transmission and distribution of electricity.

A.A.C. R14-2-1611 (E) provides that an ESP governed by Article 16 may price a competitive electric service at any level at or below the maximum rate stated in the company's tariff, provided it is not below the marginal cost of providing the service.

This pricing rule allows an ESP to use flexible pricing for any of its competitive services. Flexible pricing is a desirable policy when alternative ESPs are allowed to offer competitive services within the same service territory that has been opened for competition.

B. Proposed Tariff, Terms and Conditions of Service, and Fair Value

The Applicant has submitted proposed tariffs. Dynegy has indicated in its tariff that the maximum rate charged for the provision of retail electric energy will be 25 cents per kilowatt-hour. The rate proposed by Dynegy can be viewed as a reasonable maximum rate if the market will be competitive or if the market will transition to competition. Although Dynegy has proposed a maximum rate that is substantially higher than current rates, the effective price that Dynegy will likely charge is anticipated to be substantially lower than its proposed maximum rate due to the company's lack of market power and limited name recognition in Arizona. If approved, Dynegy will likely be unable to charge rates in excess of the Affected Utilities' standard offer rates, because the standard offer rates will be the prevailing and alternative prices.

Dynegy also intends to resell Metering Service to its Arizona customers. Dynegy has indicated in its proposed tariffs that the rate charged by the Commission-certificated MSP or MRSP will be passed through without markup to the customer.

Dynegy also intends to provide billing and collection services. Dynegy indicated in its proposed tariffs that market-based billing and collection charges will be included in the charge for electricity supply or itemized on a customer's bill.

The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from the Company and has determined that its fair value rate base is zero. Accordingly, the Company's fair value rate base is too small to be useful in a fair value analysis. In addition, the rate to be ultimately charged by the company will be heavily influenced by the market. Therefore, while Staff considered the fair value rate base information submitted by the company, it did not accord that information substantial weight in its analysis.

C. Conclusion

Dynegy will be providing service in areas where an Affected Utility company is providing service. Therefore, Dynegy will have to compete with the existing electric service providers in order to obtain subscribers to its services. Because Dynegy will face competition in providing service to its potential customers, Dynegy will not be able to exert monopoly power. Thus, the competitive process will result in rates that are just and reasonable. Staff has made a fair value finding in its analysis. Staff recommends that the fair value information provided not be given substantial weight in analysis and consideration of this application.

2.6 OTHER APPLICATION ITEMS

A. Data Systems Management

Dynegy has implemented an electronic data interchange system to manage its transactions with trading partners and other market participants with whom it must exchange information. Dynegy has indicated that it has established a communication network across the nation, which equips it for effective communication and data exchange in the market place. Dynegy has also indicated that it has established communication with the New York Independent System Operator, the California Independent System Operator, and the Electric Reliability Council of Texas.

Dynegy has indicated that it is equipped with business systems and resources necessary to manage and process customer data. Dynegy's parent company, Dynegy Holdings, Inc. has a computer center located in Houston, Texas that has a fully equipped data center that uses Hewlett Packard and Compaq servers running Unix and Windows NT operating systems.

B. Scheduling Coordinator

Dynegy has submitted a service acquisition agreement with a Scheduling Coordinator as part of its application. That agreement is pending review for the Director of the Utilities Division's approval. Commission rule R14-2-1603 (G)(3) and (6) requires that the service acquisition agreement be approved by the Director of the Utilities Division, prior to the provision of service to Arizona customers.

Staff recommends that Dynegy's certification be conditioned upon Dynegy obtaining approval from the Director of the Utilities Division of its service acquisition agreement with a Scheduling Coordinator. Staff recommends that this approval be obtained prior to the provision of any competitive service.

C. UDC Service Acquisition Agreement

At the time of filing its application, Dynegy had not entered into a service acquisition agreement with any UDC in Arizona as required in R14-2-1603 (G)(3) and (6). As soon as a service acquisition agreement is negotiated with a respective UDC, Staff recommends that Dynegy provide that negotiated service acquisition agreement to the Director of the Utilities Division for approval.

Staff recommends that Dynegy's certification be conditioned upon Dynegy obtaining approval from the Director of the Utilities Division of a service acquisition agreement with the UDC in each service area to be served. Staff recommends that this approval be obtained prior to the provision of any competitive service.

3. CUSTOMER SERVICE

Dynegy has stated in its application that it will not be collecting deposits or other funds in advance of providing services and therefore, will not be required to provide a credit evaluation, security deposit or bond to cover customer deposits. However, if in the future Dynegy desires to charge its customers deposits or advances, Staff recommends that it comply with Commission policies regarding deposits and advances.

To address concerns of its customers concerning default or nonperformance, Dynegy will provide proof to Staff that it has been found creditworthy by the UDC under its credit terms. Specific credit terms will be negotiated by Dynegy with the UDC. Staff recommends that to guarantee or protect against any possible default or non-performance, Dynegy will provide Staff with evidence indicating that the UDC has found it creditworthy prior to provision of any certificated service. In addition, Staff recommends that Dynegy post a performance bond in the amount of \$100,000 to cover any costs that the customer may incur as a result of non-performance or default by Dynegy. Staff further recommends that the Commission be permitted to evaluate the amount of the bond at any time. Proof of the performance bond should be docketed within 365 days of the effective date of an order in this matter or 30 days prior to the provision of service, whichever comes first.

Dynegy has a customer service contact established for customers to call regarding any competitive service matter. If competitive service is no longer provided by Dynegy and no other competitive service request is initiated by the customer, service will revert to standard offer service from the UDC.

4. RECOMMENDATIONS

This section contains the Staff recommendations on Dynegy's application for a Certificate of Convenience and Necessity to provide competitive retail electric services and Illinova's request to cancel its certificate. Dynegy is seeking certification as an ESP to provide retail electric power service.

Dynegy will also provide meter service through a resale arrangement with a Commission-certificated provider of meter service and meter reading service.

While Dynegy is not requesting certification at this time to directly sell meter service, Dynegy would be required to acquire Commission approval in another CC&N application prior to providing the metering services itself.

Dynegy does not own any electric generating capacity and will acquire its power from the wholesale market.

Based upon its technical capability and financial resources, Staff recommends that the Commission grant Dynegy's application for a CC&N to provide competitive retail electric service which includes the reselling of meter service and meter reading service subject to the following recommendations:

1. Dynegy must either be its own scheduling coordinator, or have a service acquisition agreement with a Scheduling Coordinator before it provides service. Dynegy has submitted a service acquisition agreement with a scheduling coordinator as part of its application. The service acquisition agreement must be approved by the Director of the Utilities Division, prior to the provision of service in a service area.
2. Dynegy must have a service acquisition agreement with the Utility Distribution Company in each service area to be served that is approved by the Director of the Utilities Division, prior to the provision of service in that service area.
3. Dynegy will provide the Director of the Utilities Division with evidence indicating that the UDC has found Dynegy creditworthy prior to provision of any certificated service.
4. Dynegy should apply to the Commission for approval prior to provision of any other competitive service not approved at this time.
5. Dynegy should not be authorized to provide competitive service in the certificated area of an Affected Utility until the Commission has reached a final resolution in that Affected Utility's respective stranded cost and unbundled tariff filing.
6. Staff recommends that the fair value information provided not be given substantial weight in analysis and consideration of this application.
7. If in the future Dynegy desires to charge its customers deposits or advances, Staff recommends that it comply with Commission policies regarding deposits and advances.
8. Dynegy should post a performance bond in the amount of \$100,000 to cover any costs that the customer may incur as a result of non-performance or default by

Dynegy. The Commission should be permitted to evaluate the amount of the bond at any time.

9. Proof of the performance bond should be docketed within 365 days of the effective date of an order in this matter or 30 days prior to the provision of service, whichever comes first.
10. The Certificate of Convenience and Necessity issued to Illinova Energy Partners, Inc. in Decision No. 61707, Docket No. E-03662A-98-0675 should be cancelled.

Staff further recommends approval of the application subject to the following conditions:

1. Dynegy should acquire all necessary licenses prior to providing service.
2. Dynegy should be required to file its tariff within 30 days of an Order in this matter, and in accordance with the Decision.
3. Dynegy's failure to timely comply with all the conditions enumerated above should result in its CC&N becoming null and void without further order of the Commission and no time extensions for compliance shall be granted.

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